

BEST'S REVIEW

STORMY Weather

by Lori Chordas

After a long stretch of relative calm, losses are growing for homeowners insurers following hurricanes Harvey, Irma and Nate. In Florida, local regional writers may still be put to the test.

For more than a decade, homes lining Florida's palm-fringed coastlines sat untouched by a major hurricane. The last major storm to hit the Sunshine State was Hurricane Wilma in 2005.

But that all changed when Hurricane Irma the most intense Atlantic hurricane to strike the United States since Hurricane Katrina in 2005 made landfall on the Florida Keys in September as a Category 4 storm. The 400-mile-wide deadly hurricane then swept across Florida, spawning several tornadoes, significant flooding in Jacksonville and widespread power outages across the state.

No longer was Florida's homeowners insurance market sitting quiet. About 88% of Irma-related insurance claims came from homeowners—the majority in the southern and central parts of the state, according to news reports.

In the Florida Keys the area hardest hit by the storm very few homes were left unscathed, with one-quarter destroyed and 65% sustaining major damage, according to the Federal Emergency Management Agency.

Despite those numbers, homeowners carriers were spared a worst-case scenario because the storm weakened slightly as it passed over Cuba and then took a more westerly path over Florida, leaving Miami relatively unscathed.

U.S. insured losses from Irma were estimated to reach at least \$18 billion and as much as \$55 billion. At \$18 billion, Irma would rank as one of the top five costliest hurricanes in terms of insured losses, according to the Insurance Information Institute.

While those losses are significant, the industry as a whole is well capitalized. Reinsurance will help to offset some of the homeowners insurers' losses. And tougher building codes, enacted following Hurricane Andrew in 1992 and its destruction of some 25,000 homes in the state, also have helped to mitigate losses.

In Florida, however, there has been an increase in the number of more concentrated/local regional writers over the past decade, according to a Best's Briefing, and those insurers have not been subject to an intense storm such as Irma.

"It is still too early to tell how much of an impact the storm will have but these companies have narrower profiles and are more likely to experience larger swings in operating performance owing to severe weather events than national carriers," according to the report, Hurricane Irma Tests Newer Participants in Florida Market. (See excerpt on page 65.)

"Still, even though losses will clearly not be as severe as originally thought, Irma will remain a sizable event and will test the infrastructure and, potentially, the financial wherewithal of some writers, particularly those that are concentrated," the report said.

Standing Strong

In addition to Irma, Hurricane Harvey pummeled Texas with record rainfall and Puerto Rico suffered severe damage from Hurricane Maria. Hurricane Nate made landfall in early October in Louisiana and again near Biloxi, Mississippi, causing an estimated \$500 million in insured losses. And hurricane season does not end until Nov. 30.

This year's string of land-falling storms comes after a period of relative inactivity.

Over the past five years, rates in the U.S. homeowners' insurance market in hurricane prone areas have declined nearly 40%, said West McAdams, president of CRC Insurance Services' managing general agency, SCU. Before the recent hurricanes, excess and surplus lines homeowners' rates in coastal areas were approaching those in noncoastal areas, he said.

There has also been a softening of the coastal windstorm market, and hurricane deductible levels have come down in some states from 5% to 2%-3% or lower.

Insurers also have been willing to relax some deductible requirements. "We're starting to see more named storm deductibles versus wind and hail deductibles—something agents and insureds have long been looking for," McAdams said.

Hurricane deductibles apply to damage solely from hurricanes, according to the III. Windstorm or wind/hail deductibles apply to any kind of wind damage.

Hurricane deductibles are now applied in 19 states and the District of Columbia and are a way for consumers to share more of the hurricane risk with insurers, said Hugo Alvarez, an attorney and shareholder with Miami-based Becker & Poliakoff.

This year's hurricanes have raised questions about the outlook for the homeowners insurance market. It was not yet clear whether this year's losses would be enough to begin to drive up the price of reinsurance and lead homeowners insurers to raise their rates as well.

"I would be surprised to see any kind of significant changes to this market going forward," said Michael O'Malley, senior vice president for public policy at the American Insurance Association.

“Our industry has record capital and these are not unknown types of events. Carriers are well aware of the potential these storms can bring,” he said.

“The good news is that insurers are more prepared than ever to manage them—both from a reinsurance and cat bond perspective and from the use of predictive and cat modeling.”

One thing, however, is clear.

The losses from Irma would have been worse if it were not for Florida’s strict building codes. With construction in coastal areas increasing, strong building codes are playing an important role in minimizing damage.

Nearly 40% of the nation’s population lives in coastal shoreline counties, often within miles of the seaboard, according to 2014 Census data. By 2020, population density in coastal areas is expected to increase by 10 million people, or 8%, according to the U.S. Department of Commerce’s National Oceanic and Atmospheric Administration.

That places increased pressure on the housing market, said Christopher Hackett, senior director of personal lines policy at the Property Casualty Insurers Association of America. “We’re seeing new construction in some of the most disaster-prone areas along the coast,” Hackett said. “But thanks to stricter building codes in states like Florida, we’re optimistic that will fare well for the market.”

Florida’s building codes today—the most stringent in the nation—stipulate all new structures undergo tougher inspections; have shatterproof windows, fortified roofs and reinforced concrete pillars; and be built to withstand winds of 111 mph and higher (or at least 130 mph winds in Broward and Miami-Dade counties).

Irma was a stress test for those codes and they’re passing the test, said James Lynch, chief actuary at the III. “Many of the newer homes built with those codes were remarkably resilient and damage was much lower than expected.”

Focusing on Florida

In Florida, homeowners insurance can be a risky business. The state has the largest number of people and property exposed to the destructive forces of hurricanes of any state.

Today, insured property values in coastal Florida counties top \$3 trillion in aggregate, according to catastrophe modeling firm AIR Worldwide. And the state's population in coastal areas grew 27% to 19.8 million between 2000 and 2015, according to the U.S. Census Bureau.

Over the years, Florida has been hit by some of the nation's most deadly and destructive hurricanes, including Andrew, Wilma, Charley and Katrina.

"The absence of a hurricane landfall in the state over the last decade has lowered reinsurance prices, which along with the growing competitiveness of the cat bond market, is allowing carriers to put in reinsurance and bond structures that have significantly helped protect their bottom line and grow their businesses," the AIA's O'Malley said.

For homeowners insurers in Florida, the relative quiet, in addition to spurring competition, has allowed them to build up surpluses.

"For the past decade, the market enjoyed a stretch of quiet hurricane activity, and private carriers and state-backed insurer Citizens Property Insurance Corp. were able to build up some pretty substantial surpluses, which will definitely help in a year like this," Hackett said.

Citizens, formed in 2002 in a merger of the state's wind pool and former state-run property insurer JUA, for years dominated the Florida market. At its peak, Citizens covered more than 20% of the residential property market, according to A.M. Best.

In 2011, the company opened up its books and let private carriers purchase many of its profitable policies, a move that should help to reduce the risk for Citizens. But for other insurers that took on those policies, the outlook is less clear.

A.M. Best, for instance, in late September revised the outlooks to negative from stable and affirmed the Best's Financial Strength Rating of A- (excellent) of Tower Hill Prime Insurance Company, based in Gainesville, Florida.

The revised outlook, the rating agency said, reflected multiple years of unfavorable underwriting performance as a result of weather-related losses, adverse development, and the ongoing pressure stemming from the assignment of benefit issue in Florida. Operating performance is not expected to improve in 2017 as the impact of Hurricane Irma is projected to drive an underwriting loss for the year.

In an effort to reduce risk, larger, national carriers such as State Farm took steps after Hurricane Andrew to significantly scale back the number of homeowners policies they wrote in the state.

"I don't think we'll see that kind of dislocation in the market where various larger insurers will decide they need to trim their presence and some smaller carriers may be forced to close their doors," the III's Lynch said.

"Each of the recent storms hit within the realm of predictability," he said. Good idea that storms like those could hit those areas, so none of the events were that much of a surprise to the homeowners market."

One thing that may change, however, is increased consolidation among startup providers, said Grant Blackwell, owner of Coastal Insurance Agency in Santa Rosa Beach, Florida.

Indeed, A.M. Best in its report said: "Smaller or struggling companies may opt to pursue mergers and acquisitions, already occurring in the market." In addition, A.M. Best said "the storm could prompt some concentrated

companies to increase their focus and efforts on diversifying outside of Florida, while others may revamp products to more desirable coverages.”

Turning to Texas

The Texas coastal homeowners market dodged a bullet during Hurricane Harvey, which made landfall as a Category 4 hurricane near Port O’Connor, south of Houston.

The insured loss from Hurricane Harvey was estimated at more than \$10 billion by catastrophe modeling firm AIR Worldwide, which would make it one of the top 10 costliest hurricanes in terms of insured losses.

Damage from Harvey was primarily the result of catastrophic flooding, which meant that homeowners insurers were spared the brunt of the losses. That’s because homeowners policies typically exclude coverage for flooding. Auto insurance policies, however, typically will pay for a car’s flood damage under the comprehensive coverage.

“Harvey actually turned out to be more of an auto insurance event,” Lynch said. Early estimates claim more than 500,000 vehicles were damaged—double the number of vehicles destroyed by Hurricane Sandy in 2012.

Homeowners may buy a flood policy either from the NFIP or the private market, but prices are often high and takeup is usually low.

That’s a growing trend across the nation’s coastal areas, PCI’s Hackett said. Nationally, the number of coastal homeowners with flood coverage has declined 10% and almost 16% in Florida, according to recent reports.

Rising premium costs are one factor discouraging homeowners from buying flood insurance, Hackett said. Another reason is lax enforcement of a requirement that homes in high-risk areas with federally insured mortgages have flood insurance, he said.

In Texas, one of the main players in the Tier 1 coastal region is the Texas Windstorm Insurance Association.

“Overall, the private insurance market has limited exposure to Tier 1 business and we do not foresee that significantly changing,” said Angelo Lozano, a property/casualty financial analyst at A.M. Best.

Homeowners insurers are taking a closer look at business in Harris and select coastal counties in the southeastern region of Texas where Hurricane Harvey did extensive damage. Houston, Texas’ largest city, is located in Harris County and was hard hit by the storm.

“They are prepared to adjust rates if necessary and will explore opportunities to gain market share if and when market disruption occurs, particularly if they occur along coastal communities and Harris County,” Lozano said.

“Some insurers have expressed they will be withdrawing from windstorm/hurricane coverage in coastal areas such as Jackson County, but we expect that to be a very small amount relative to the overall capacity currently offered in the Texas market.”